

CRUDE OIL VALUATION WORKSHOP (September 30 - October 1, 1997)
DENVER, COLORADO

ATTENDEES

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September 30, 1997

CRUDE OIL VALUATION WORKSHOP

9:00AM

Deborah Gibbs Tschudy

- Administrative Items
- Other workshops planned
Houston 10/7 through 10/8/97
Houston 10/14/97
- Everyone may speak (as opposed to round table, industry/States in 1st and 2nd workshops).
- Working on additional workshops in Bakersfield, Casper 10/16/97 -- intent is to reach independents looking for input on alternatives -- trying for Roswell 10/21/97

Valdean Severson

- Suggested Midland as alternative to Roswell

Deborah Gibbs Tschudy

- Not attempting to reach consensus
- Won't discuss RIK
- Covered agenda--identify action items for next meeting (Houston 10/7-10/8)--Noted that agenda came directly from Federal Register Notice
- Introductions of attendees

Ben Dillon (on behalf of IPAA)

- IPAA has approached MMS to get extension of the rule making process--they see it as needed to give the effort the time needed. Intent to understand better MMS's concerns/needs.
- IPAA has put benchmarks on table. Agree regulations need to change and that postings should be removed.
- Won't be able to get the job done in the limited time available in these meetings--thinks there's opportunity for finding common ground, but need time.
- Handed out joint DPC/IPAA letter to Cynthia Quartermain. Thinks duty to market is still major problem--needs more discussion and thinks should be removed from regulation.
- Thinks MMS needs to flush out "call" intent better.

Deborah Gibbs Tschudy

- Let's see how workshops go before worrying about further extension

Ben Dillon

-- Still wants firmer commitment to extension

David Blackmon

-- Wanted to know why MMS hasn't addressed (Expanded) duty to market issue even though we received many comments on the issue?

Don Sant

-- Doesn't think the duty to market language is expanded--has always been there.

Ben Dillon

-- IPAA doesn't know where its final position will be after workshops--affiliate, duty to market, gross proceeds--all important to IPAA

Dave Deal

-- API concerned process isn't truncated early--on some of the best thoughts will surface after comment period. Thinks later comments will be appropriate, even after comment period.

Deborah Gibbs Tschudy

-- Guidance from Director is not to extend at this point.

Hank Banta

-- Thinks, from California perspective, process has dragged on interminably. If extended further, perhaps a separate rule for California should be written.

Becky McGee

-- Hard to see how a fair read can be given by October 22, 1997, to look at alternatives presented in Federal Register notice.

Ben Dillon

-- Appreciates opportunity to participate. Disappointed that RIK not on table here, but will bring it up as alternative valuation method.

Dave Darouse

-- Views offshore as more amenable to regulations as proposed (or alternative index Louisiana suggested)--perhaps offshore may warrant separate rule if overall process otherwise hungup.

Deborah Gibbs Tschudy

-- Discussion of 1st alternative--value production not sold arm's-length on prices received in outright sales (i.e., "tendering programs") under bid out programs.

-- Should minimum amount of production be offered under such a program?

John Clark (Conoco/COPAS)

-- Turned over to John Haley to describe Conoco tendering Program

John Haley

- 1996: evaluated alternatives for reasonable valuation. Felt tendering program least contentious and best to get fair price at lease. Believed price at trading market not representative of lease price.
- Doesn't include 3rd party production.
- Identified some areas where, if bid out, Conoco would lose money because of remoteness (such as Four Corners area).
- Identified price districts--15 in Midland/West Texas area
- Spread effort out--doing \approx 8 months of year--bids for 6 months terms--limited by resource constraints. (Lack of people to keep up with contracts, and bidders needed continuity, so didn't do monthly--tried to spread out bid process).
- Identified array of potential bidders-- \approx 25 -- min. qualifications established such as financial backing.
- If Conoco got $<$ 2 bids, would rebid--same if prices not indicative of value.
- Conoco intends to sell 10 percent of production under tendering program --their economic consultants think 10 percent is good minimum threshold (& sometimes 5 percent may be good)
- Some bids for limited volumes appeared to be higher than market because of premiums paid.
- Qualifying bid has to be on a minimum volume, up to a maximum volume established by Conoco.
- If price below what Conoco thinks it's worth, Conoco (downstream) reserves right to buy remaining 90 percent at bid prices. But if prices too high, will sell remaining volumes to bidders.
- Looking at enhancements--example: First bid out 10 percent in a given area, then remaining 90 percent in total lot (perhaps in remote areas).
- Feels owner has interest in getting best price for everybody!

Deborah Gibbs Tschudy

- To John--how do you assure that Conoco is bidding out representative qualities?

John Haley

- Tries to assure that similar quality crude bid out as compared to that oil valued otherwise. Uses 10 percent volume to price all crude in that district.
- Thinks that if bundled up larger volumes--say 30 percent--may get lower prices.
- Bundles up all production--Federal, State, fee--for bidding out.

John Clark

- Bidding program allows bids on from 10 percent to 100 percent of production, but Conoco only obligated to sell up to 10 percent.

Bonn Macy

- How determine posting used?

John Haley

- Uses Koch (buyer's) posting--Koch posting underlies P-Plus in Platt's also. Uses

Marathon in Wyoming because Marathon more active there.

Deborah Gibbs Tschudy

-- How often sell \geq 10 percent?

John Haley

-- More often than we thought

Dave Loomis

-- How does Conoco decide which volumes go to whom?

John Haley

-- Couldn't build matrix for balancing volumes/prices, so didn't try.

Dave Loomis

-- How develop pricing districts?

John Haley

-- Looked at individual marketing, geographical, etc., characteristics. Leases on fringe of producing area may not be worth bidding out.

John Munsch

-- Wouldn't transportation affect economic value to bidders, even if leases in fairly close proximity?

John Haley

-- Yes. Leases $\frac{1}{2}$ mile apart in North Dakota, but transportation costs may vary tremendously--say, because of Badlands location.

Peter Christnacht

-- How does Conoco average costs for leases in area with very different costs (e.g., transp.)?

John Haley

-- If bid price below what Conoco willing to pay, Conoco will sell the 10 percent but buy the rest. 10 percent may not be enough in some areas to attract bidders.

Peter Christnacht

-- If you won't allow bidders to take "easy oil," how do you establish bid requirements?

John Haley

-- Bidders can't just bid on "easy oil" $\circ\circ$ must bid average price on all oil offered for bid. Anyone with ownership interest would get the bid price for royalty purposes.

David Darouse

-- If bid out more than 10 percent, would bonus be higher?

John Haley

- Bonuses probably would go down. Thinks minimum of 10percent best represents value.
- If bids volume-limited at significant bonus, Conoco may offer more volumes to flush out “real” price. Volume-limited bid may be high.

John Munsch

- Timing also affects price.

Dave Darouse

- In term deals, bonus set for 6 months?

John Haley

- Yes. Spot market may, at times, go above contract price. P-plus may end up being better deal in some cases. Part of marketing--risks involved.
- Over time, Conoco thinks bid price best deal for all involved.

Dave Darouse

- Bid prices tend toward WTI spot price at Midland?

John Haley

- Probably so, over time--perhaps even better.

Jerry Hutchinson

- Tried program in Wyoming?

John Haley

- Yes, although Conoco has limited production there.

Jerry Hutchinson

- If get bid price for a unit, how far out can you extend that price?

John Haley

- Depends on type of crude (asphaltic, etc)--Conoco has only 1 unit in Wyoming. Look at sweet vs. sour, other qualities to establish areas.
- Posting itself already includes quality (grav.) adjustments.

Deborah Gibbs Tschudy

- How get representative (quality) sample for districts?

John Haley

- Groups crude by quality in “districts”. Deems all crude at 40°

John Munsch

- Posting itself includes gravity adjustments, and leases grouped together by unit or types.

John Haley

- If bidder sees quality adjustment needed, must put in their bid. Conoco deems production at 40°

Deborah Gibbs Tschudy

- Suggesting that this benchmark stand alone? Or suggest it as one option?

John Haley

- Option. One of several alternatives--may not fit all situations. Some producers, for example, may find gross proceeds best.

Don Sant

- How did 10 percent recommended by consultants come about, and why good choice?

John Haley

- Other producers in unit may also benefit from the bid price. Can't lump in prices that others receive.

Don Sant

- Why is 10 percent good for government interests?

Becky McGee

- Need to look at comparability--volumes, time, etc. Emphasis should be on our objectives. i.e., N.A.L. transaction valued same as a.l., as adjusted for quality, etc. Focus should not be on single mechanism; rather, what's appropriate for your transaction.

John Haley

- Looking at perspective of what's in best interests of all involved. Thus sometimes have reasons for limiting volumes bid out.

Deborah Gibbs Tschudy

- Explain how/why Conoco can't "game" process to its benefit?

John Haley

- Conoco willing to have MMS audit and approve process--look at pricing districts, volumes, bid details, etc.

Ben Dillon

- Has suggested MMS can work with states and industry to establish criteria, district, pipelines, etc. To confirm system can't be gamed.

Don Sant

- Conoco buying crude in some of same places? (Where bidding oil out also) Causing Conoco to change business practices?

John Haley

- Yes, in many cases. Conoco doesn't want government or others "nosing around" in arms length sales details.

John Munsch

- Have government sell some as cross-check?

John Haley

- "Not sure competition between sellers is good" Should simply be held accountable for doing best job Conoco can do.
- Wanted process that's workable, one under which Conoco could open its books to MMS/States/others, one that prevents "gaming"

Becky McGee

- Program aims to limit materials that would be required under audit?

John Haley

- Yes, but real objective to get best price we can.

Dave Darouse

- In areas where buying as well as selling oil, index may be better way to go. Seems also that Conoco going through long administrative process and ending up back at Platt's price anyway.

John Haley

- Platt's represents price at bulk trading center--can't yet fully answer Dave's observation until more time under bidding program passes.
- Differentials from NYMEX will always be contentious, whereas lease prices shouldn't be.

Dave Darouse

-- Doesn't support RIK, but Conoco is basically marketing our oil in-kind.

John Clark

-- Totally disagrees. Does offer minimum volume, but using that value against 100 percent of supply. In out-of-way location, 100 percent of volume may be bid out.

Dave Darouse

-- Looking at program from OCS situation.

Don Sant

-- How many pricing districts?

John Haley

-- Think 5, now. Thinks each company should define their own plan for MMS review

Don Sant

-- See this program as satisfying more than just MMS royalties?

John Haley

-- Yes-benefits all interest owners, and there are good business reasons to get best price available.

Don Sant

-- "Doesn't want royalty rule to change how industry does business."

Ben Dillon

-- "Will you put that in writing?" (Laughter!!!)

John Haley

-- Conoco better off now than the way they were doing it before--in some cases bids higher than Conoco would have paid.

Hank Banta

-- Really practical for MMS to be looking over Conoco's/others' shoulders? Ss correct to leave potential for second-guessing?

John Haley

-- Comes back to objective of getting best price it can.

Don Sant

-- If refiner retains 90 percent, the 10 percent volume may not reflect best price available. (Implies refiner downstream can't get replacement crude cheaper.)

John Clark

-- Not clear this is a correct assumption.

John Haley

- May be case--specific situation that other refiners don't have--not necessarily correct assumption. Conoco has choice to match prices.

Becky McGee

- MMS shouldn't "feel bad" if they accept market bids.

(11:00AM break)

Debbie Gibbs Tschudy

- Should we stay with Alternative 1?

Dave Deal

- Yes. Stick with Alternative 1

Bob Fees

- What other majors do this?

John Haley

- Texaco, Marathon, University of Texas bid out oil production

Becky McGee

- Oryx doesn't have a specific program in mind but does bid some crude out to determine market value.
- Texaco program works best in specific areas

Randy Bolles

- This means there is an administrative burden on company. MMS would also have to scrutinize even more than current audit burden.

David Darouse

- Look under 88 regs. Tender system would increase burden for both companies and MMS.

John Haley

- Audit request for documents is real burden. Will simplify burden.

Dave Blackmon

- Does MMS propose to lay off audit staff?

Don Sant

- The proposal on the table will simplify audit. Audit burden would be reduced. This proposal would minimize audit burden on both MMS and the companies.

Dave Deal

-- Let's talk about the concern MMS has about gaming.

Deborah Gibbs Tschudy

-- Using Conoco's method, MMS would give the approval, audit burden would be up-front

Don Sant

-- I am concerned that in Texaco and Conoco's tendering programs there is room for companies to game the value.

John Haley

-- There's no obligation for reciprocal purchase.

IPAA

-- Tendering would be the first benchmark. Should there be an order placed on these benchmarks?

Becky McGee

-- DPC's submittal is their preference of order on May 28 comments. Conoco is not the only model for tendering. What lessee receives for comparable arm's-length transactions.

Mary Stonecipher

-- Third party sales part of the benchmark mix.

David Blackmon

-- Conoco is only an example.

Bob Fees

-- To Conoco, how does a pricing district tie to field or area?

John Haley

-- Judgement. Experience may force adjustments. There is a need for flexibility -- we would have to work with MMS.

John Munsch

-- Could group like-crudes together from same geographic area.

Dave Blackmon

-- Similar crudes that serve same area would be grouped together.

Don Sant

-- Rules would need to give data one month after production occurs. This is the problem we tried to solve in 1988.

-- Why is everyone using postings without backup of true outright sales?

Deborah Gibbs Tschudy

-- This proposal is not much different than current system.

Mary Stonecipher

-- There are significant quantities tendered.

Deborah Gibbs Tschudy

-- There needs to be minimum quantity.

-- What can we do to minimize audit burden?

Mary Stonecipher

-- Yes we need that.

Becky McGee

-- What do you need? All Contracts? Volumes? Percent of fields?

Deborah Gibbs Tschudy

-- We need information for payors to report on 30 days after production occurs. We don't foresee the need to have all the volume from a field or area.

Becky McGee

-- One way to do this is to certify up-front that there is not overall balance

Deborah Gibbs Tschudy

-- Need to reduce burden

Hank Banta

-- Litigated issue of depletion allowance. Lots of case law on books

Randy Bolles

-- Under benchmark 3

Comp A sells production at a central point

Comp B sells at lease

} DIFFERENT VALUES FOR SAME OIL

-- This occurs often in WY. Don't have information to determine value here.

-- need more specificity on benchmark 5 (netback)

Valdean Severson

-- Throw out benchmark 3 comparables won't work.

John Munsch

-- Need to know what other companies are doing to determine what the value of the oil is.

Randy Bolles

-- Yes.

John Munsch (DPC/Santa Fe)

-- Benchmark 3 should not be thrown out.

Deborah Gibbs Tschudy

-- Companies don't have access to price and antitrust is an issue Benchmark 3 won't work.

-- It has not worked to date under the current system. Let's move on.

Ben Dillon

-- Second set of comments suggest that burden be on producer. If a company has the data it should use the 3rd party data it knows about. The volumes should be 10 percent of lessees production.

John Haley

-- Is 10 percent right number? We asked economist this question. You must put enough volume up to get bidders. How do you put volume on area? Different quantities for each field.

Dave Hubbard

-- What is threshold?

John Haley

-- You use your best judgement. It depends on the situation. You want market value for cluster of leases otherwise companies bidding will change -----10percent

Deborah Gibbs Tschudy

-- Need a field or area minimum amount.
What is definition?

Ben Dillon

-- We would negotiate this in advance.

Deborah Gibbs Tschudy

-- Up-front burden would be high. Administrative effort very high.

Ben Dillon

-- It would be the same for NYMEX scheme.

Mary Stonecipher

-- Let's combine benchmarks 1 and 2. 10 percent raise to higher percent if small field.

Ben Dillon

-- IPAA concerns

Don Sant

-- Would API members share information?

Dave Deal

-- API doesn't have this?

Mary Stonecipher

-- An affiliate would have some of this information.

Don Sant

-- The trust level of data hasn't been addressed under this idea.

Ben Dillon

-- Benchmark 1. As one way to get to value IPAA suggests a weighted average of range of values.

Deborah Gibbs Tschudy

-- Second alternative MMS is uncomfortable with 10 percent under the tender program.
Wants company to put its production at risk 50 percent.

Mary Stonecipher

-- For large fields there will be difficulties in getting each field and or area judged using own data.
-- Economic interest will be different in different fields.
-- Your total number of barrels will be different in different areas.

Ben Dillon

-- Should we move on to other issues?

Deborah Gibbs Tschudy

-- What about the benchmark order? Do we use the higher of Benchmarks or first applicable benchmark? Let's hear from the States!

Dave Darouse

-- There are no real sales in the Gulf.

Ben Dillon

-- There is an active market at lease. We are willing to shoulder the burden of determination.

Don Sant

-- Won't some payors go to benchmark? So, we still have burden of both systems.

Ben Dillon

-- All companies being forced to net back unacceptable.

Don Sant

-- Can we get the info to players quick enough for them to use real time comparison to pay their royalties.

Ben Dillon

-- We would like to do this.

John Haley

-- In the Gulf, we bid out at aggregation points; this is the preferred way to go. Conoco's uncomfortable with NYMEX approach.

Deborah Gibbs Tschudy

-- The key is to construct benchmark using available data. Need assurance sale is arm's length and that all consideration is accounted for.

Ben Dillon

-- We will discuss how to increase your confidence. What don't you trust?

Peter Christnacht

-- How would you get us assurance you are not taking best 10 percent (i.e., cherry picking your information to provide the 10 percent that gives the lowest royalty?)

Becky McGee

-- How do you assure industry that cost is certain up-front?

Deborah Gibbs Tschudy

-- How do we know if production is like quality--intent is to simplify burden.

Becky McGee

- It's one thing to say use what you have available. Something else to say there are some others that match or fall in window of acceptable values. We don't want second guessing. . . audit to come back later and tell us more royalties are due.

Deborah Gibbs Tschudy

- Let's make this an action item to come back with ideas to solve this concern.

Becky McGee

- We will look at this.

David Blackmon

- We will have two working days to do this.

Deborah Gibbs Tschudy

- These are your benchmarks, we want your help.

Valdean Severson

- This is not a new problem. 10 years of experience tells us we must move out of the '88 regulations. This also won't work in captive seller market

Becky McGee

- Captive sellers are out of luck--this is market in these areas.

Hank Banta

- Is there anyway to not rely on gross proceeds under the proposed benchmark?

Becky McGee

- Much of our arm's length sales would be knocked out under that scenario

Ben Dillon

- We sense MMS hesitancy in the latest Federal Register notice--on these issues. What has changed.

Deborah Gibbs Tschudy

- The proposed and supplementary are to be taken in tandem.

David Darouse

- What does producer do as captive seller--too little oil to market. Should not drive value of 90 percent of the oil.

Becky McGee

-- I am not sure I understand your point.

Dave Darouse

-- Is it any less fair for government to dictate differential price for producers than for 10% of production for 50 different owners?

John Clark

-- If one of 50 producers does an exchange you jump him to NYMEX value.

Dave Blackmon

-- So 10 percent for constrained seller is constrained not considered market value.

Don Sant

-- Need 50 percent.

Deborah Gibbs Tschudy

-- Or put enough at risk to show this is the proper value.

Mary Stonecipher

-- The right percent should be based on marketers out there. It will be different in different areas.

(LUNCH)

Deborah Gibbs Tschudy

-- What about retaining gross proceeds minimum?

Debbie Hagland

-- Maybe retain, but not incorporate affiliate gross proceeds.

Dave Deal

-- Meeting is helping him sharpen some questions and crystallize issues--no opinion on gross proceeds at this time.

Carla Wilson

-- Why need a minimum if price resolved under benchmarks?

Ben Dillon

-- If MMS needed a check, comparison to affiliate resale is "apples & oranges."

Hank Banta

-- Doesn't like benchmarks at all.

Becky McGee

-- Have already established value under benchmarks--why compare to gross proceeds?

Implies you're only interested in raising more dollars.

Dave Darouse

- If refine oil and don't sell, comparable may apply; should, however, track gross proceeds of affiliate less appropriate adjustments (transp/qual.)

Ben Dillon

- There's a cost to set up an affiliate, thus cost to market, the product--hence there's more cost than just transportation/quality adjustments.

Randy Bolles

- Brought up past argument that lessee gets 87 1/2 percent of value of production--thus expected to incur any other costs of marketing.

David Blackmon

- Proposed rule moves valuation away from lease to Cushing.

Ben Dillon

- IPAA thinks there's long list of costs that should be deductible.

Becky McGee

- There are costs that should be deducted because lease doesn't require lessee to incur them.

Hank Banta

- These are matters of fact/interpretation; doesn't explain value differences seen in practice.

Deborah Gibbs Tschudy

- Thinks these are legal issues in addition to factual.

Hank Banta

- Can't explain differences between, say, postings and ANS spot price by marketing costs.

Dave Darouse

- When an arms-length sale occurs, "ride with the producer" and don't benchmark.

Valdean Severson

- Resale by affiliate at gross proceeds acceptable.
- Doesn't recognize benchmarks at all.
- If refiner, use spot market netback price.

Deborah Gibbs Tschudy

- If have benchmarks, should we use higher of benchmarks or gross proceeds ?

Ben Dillon

- Worth exploring whether certain costs deductible?

Dave Darouse

-- Supports going through courts to determine whether costs deductible.

Valdean Severson

-- MMS should share in some of marketing costs, but not sure how much.

Becky McGee

-- What driving non-deductibility of marketing costs idea? Simply raising more revenues, trying to determine what is market value?

Debbie Gibbs Tschudy

-- The latter.

John Clark

-- Why is NYMEX a proper value? Or spot prices? They are just paper markets.

Dave Darouse

-- There's a real market at, say, Empire--where a spot price exists.

John Haley

-- Conoco often buys on spot market, but also sometimes at lower price than published spot price.

John Munsch

-- Price paid may depend on time of day deal consummated.

Dave Darouse

-- Does Platt's survey Conoco's transactions?

John Haley

-- Sometimes.

John Munsch

-- Never in California.

R.G. Fourman

- Doesn't think Platt's spot prices fairly represent market. Rather, willing buyer/seller negotiations determine price. Platt's has never quantified barrels moving under spot prices.

Dave Darouse

- Platt's told us they spend all day sampling differentials--at end of day (last 30 minutes) determine survey price for day.

R.G. Fourman

- Platt's price doesn't reflect full day survey--rather, end-of-day only.

Deborah Gibbs Tschudy

- None of statements/comments about end-of-day survey backed by empirical data.

Deborah Gibbs Tschudy

- Regarding 5th benchmark, how should netback be determined?

Ben Dillon

- Not NYMEX, but price at aggregation point or other available price near lease. Hard to discuss netback when there's little movement by MMS on deductible costs.
- Index less transportation less marketing costs less all costs to get to market.
- Page 30, IPAA document lists suggested deductible costs.

Becky McGee

- If deductible costs are only a curiosity, move to next agenda item--otherwise let's discuss these items seriously.

Dave Darouse

- Would like to know risks lessees exposed to--Louisiana "rides along" with lessee.

Becky McGee

- Participates as hedger (Oryx).

John Munsch

- Risks include pipeline loss; environmental loss; risk of final sale; price risk; etc.

Becky McGee

- Costs have to do with actual procedures performed (rather than simply naming types of risks).

John Munsch

- Deductible marketing costs should include:
 - schedule volumes
 - maintain inventory
 - tracking volumes
 - building facilities
 - surveying markets
- etc; all are related to moving production away from lease in establishing value, and will require people and accounts

Becky McGee

- Talking about costs beyond sales at lease; need more people.

Bonn Macy

- Can estimate \$/bbl. cost to quantify such costs?

John Munsch/Ben Dillon

- Perhaps 5¢/10¢/17¢ --but company specific.

Mike Adams

- It's a disincentive to allow deductions where market is inefficient.

Ben Dillon

- Will make effort, for next meeting, to quantify marketing costs--but if academic exercise, is not worthwhile.

Becky McGee

- Agrees with Ben Dillon.

Don Sant

- If move downstream, should be allowed to deduct incremental marketing costs, but will be difficult to properly calculate those.

Bonn Macy

- Would also have to be audited.

Dave Darouse

- Doesn't necessarily like using aggregation points as starting point for netback

Deborah Gibbs Tschudy

- Emphasized that there are others in MMS who don't agree with Don regarding incremental marketing costs.

Becky McGee/John Munsch

- Feasibility of having people do these services (marketing) for a fee?

Deborah Gibbs Tschudy

- Thinks Ben Dillon, etc. should add some detailed support on specific downstream costs that should be deducted if a netback approach used.

Ben Dillon

- As long as NYMEX part of package, membership hesitant to “put more meat on the bone” for example, providing specific deductible downstream costs. But they want to know level of MMS commitment to follow-up.
- Sees following as needed from MMS request for more detail:
 - Identify deductible costs?
 - How quantify them?
 - How pick point where/to they are established?

Becky McGee

- main benchmark approach was eliminating postings. Need to address what MMS/states need/want.

Deborah Gibbs Tschudy/Ben Dillon/Becky McGee

- Summary of what needed from States/MMS:
 - Why wouldn't benchmark system work?
 - What more is needed?

Bob Fees

- California knows what it wants to do; thinks summary of what is needed from States/MMS is unnecessary?

David Blackmon/John Munsch

- Wouldn't have info to apply benchmark 3

Ben Dillon

- Have struggled with these issues since 1988--do States think we can deal with them now?

Valdean Severson

- “Kind of” likes Conoco tendering program

John Clark

- No field/area definition that fits everyone. Trying to establish market value at lease--different companies may get there in different ways. Also feels industry not getting their questions answered during this workshop, although MMS trying to get lots of information from industry.

John Munsch

- Trying to put blocks of production together as efficiently as possible--field/area thus is company-driven. Generic pricing at market center leaves out specific circumstances of different companies.

Deborah Gibbs Tschudy

- Items to cover in flushing out details of alternative 2 (benchmarks):
 - Significant quantities
 - Field/area definitions
 - How do we know contract reflects total consideration?

Dave Deal

- What are expectations of industry over next several days? Seems to be disconnect between meaty issues and time allowed to address them.

David Blackmon

- When FOIA request made as to why NYMEX appropriate, got limited response from MMS. Why should industry be held to different standards?

Valdean Severson

- Takes exception. A year ago Royalty Policy Committee product value group decided not to address the issue at all.

(BREAK)

Deborah Gibbs Tschudy

- Next workshop to give us feedback. October 22nd is last workshop. It will be open to everyone for alternative suggestions and comments.
- Question to States. Is there support for lease based Benchmarks?

Hank Banta (California)

- No. Difficult to find transactions at wellhead and can't rely on postings. Where do you go?

Dave Darouse

- Could not recommend benchmark system.
- Making prices available in meaningful way to Non-arm's length payors not practical, and significant quantities is a problem.

Dave Loomis

- Agrees with California and Louisiana position.

Randy Bolles

- Independent comparable prices--present problems with making benchmarks work, however, Wyoming is open to examining benchmarks.

Valdean Severson

- We support tender program with built in review process. We support benchmarks for non-refiners and an allowance for marketing deduction. For these payors benchmarks would be ordered as follows: Gross proceeds, consider tendering. For a refiner use NYMEX/or spot price net back.

Deborah Gibbs Tschudy

- I am hearing some support for lease based valuation from States. Wyoming Governor's office has shown some support of comparable value benchmark.

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Mary Stonecipher

- Regional valuation approach seems to be the logical consequence of what I am hearing.

Deborah Gibbs Tschudy

- Should we use lease basis in Rocky Mountain region?
Wyoming might live with some form of benchmark.

Carla Wilson

- Define Rocky Mountain region
Debbie, do I hear support for an onshore/offshore division?
If benchmark is for onshore is index for offshore?

Deborah Gibbs Tschudy

- Rocky Mountain Region (ND, MT, WY, CO, UT)

Becky McGee

- Should we define areas based on basins?

Deborah Gibbs Tschudy

- For areas such as Rocky Mountain can we segregate regions based on market driven differences?

Randy Bolles

- Sour condensate vs Wyoming Sweet very difficult to get a handle on

Deborah Gibbs Tschudy

- California different; Wyoming also may be different

Ben Dillon

- Lease comparability still important. Can't support a system that values oil away from the lease.

John Clark

- Want Valdean to repeat his proposal for refiners.

Valdean Severson

- Refiner use tender/with audit review up front if not tendered index with cost deductions including marketing deductions.

David Darouse

- Agrees with Valdean except for tendering & marketing (willing to listen to deducting marketing)

Shawna Hopkins

- States are not ready to agree to marketing costs.

Valdean Severson

- Will Conoco and Texaco come forward with any tendering short falls?

IPAA

- Disappointment with MMS position on marketing deduction. Some pleasure with New Mexico and Wyoming positions.

Mary Stonecipher

- Can we do anything to educate MMS's decision makers?

Ben Dillon

- General proposals on table could be helpful.

Becky McGee

- New Mexico warm to tendering program.

Mary Stonecipher

- Let's not forget offshore (MMS).

Deborah Gibbs Tschudy

- Do I hear some interest in separate rule for refiner vs non-refiner?

Mary Stonecipher

- Is that by location?

Deborah Gibbs Tschudy

- refinery anywhere all production is suspect. Our auditors have seen exchanges where

production is swapped for spot price oil.

Mary Stonecipher

-- Doesn't agree this should be based on all or nothing.

Ben Dillon

-- Under tendering would the amount being bid need to be audited?

Deborah Gibbs Tschudy

-- Yes, ahead of time.

John Munsch

-- Why is 10 percent not okay?

Ben Dillon

-- She thinks it needs to be a certain percent above royalty?

Dave Deal

-- Define refiner vs. Integrated?

Valdean Severson

-- Refinery buys oil to refine integrated company can sell oil for profit. Both have a marketing company. It's a gross proceeds question Refinery vs. Non refinery. If there is a true resale you establish value, refiner consumes oil-value isn't determined by Arm's-length transaction.

Don Lynch

-- Selling a minimum volume by area could be answer for valuing non-arm's-length production. Alternative 3-- use MMS (AFS) system data as comparable to find acceptable range.

Randy Bolles

-- Must exclude p-plus. MMS system currently won't allow you to do this (?)

-- How do you notify companies of these values in real time? Doubts we could make this work. Concern that in these cases we would limit company to NYMEX not comfortable with NYMEX in Wyoming.

-- Companies should only be allowed to deduct actual costs of transportation, but this causes audit problems.

-- Transportation rate is obvious in Southern Wyoming, crude goes to Salt Lake City, but you need to be able to have some way to come up with comparable value. Current MMS system won't let you do this.

Deborah Gibbs Tschudy

-- The problem is how do you verify prices in real time.

Randy Bolles

-- There will always be this problem with comparable.

Ben Dillon

-- I don't hear MMS saying it is willing to devote resources. IPAA willing to look at this if MMS is. IPAA chose to go down producer based pricing route in its proposal. Any support for this idea?

Randy Bolles

-- Wyoming supports looking beyond exchange agreements. There may be situations where we could use MMS data.

David Darouse

-- No support in Louisiana of using MMS data. Questions accuracy of Form MMS-2014 data. Raises questions about the accuracy of reporting data. Like benchmarks better but this is only a relative comment.

Randy Bolles

-- Only solution seems to be RIK.

(GENERAL APPLAUSE!)

Valdean Severson

-- Still looks like a safety net approach.

Ben Dillon

- For verification purposes it could still be useful.

Deborah Gibbs Tschudy

-- There is still an opportunity for mixing and matching of alternatives.

Mary Stonecipher

-- Tendering is not an answer in remote areas.

John Haley

-- Conoco's system can account for outliers.

Mary Stonecipher

-- We must consider the "what ifs."

Deborah Gibbs Tschudy

-- Let's make this an action item. Tomorrow we'll outline agenda items for future workshops. We'll start with differentials.

David Darouse

-- Also wants industry to address shortcoming in Gulf OCS (where proposed regulations fall

short).

(END OF FIRST DAY)

October 1, 1997

CRUDE OIL VALUATION WORKSHOP
DENVER, COLORADO

9:00AM

Deborah Gibbs Tschudy

-- Introduction. Peter Christnacht will discuss differentials.

Peter Christnacht

-- Discussed differentials using previously--developed presentation materials. Also discussed deletion of FERC tariff provision in proposed regulations.

David Blackmon

-- Doesn't see where there is a gravity adjustment in the differentials.

Peter Christnacht

-- Quality derived from Form-4415, and locality differentials.

David Hubbard

-- Would be stratified to extent possible and as data allows.

Ben Dillon

-- Membership of IPAA doesn't know the rule's intent regarding quality adjustments.

Hank Banta/John Munsch

-- Have similar problems. Quality banks used by pipelines may have reasonable quality adjustment information.

Deborah Gibbs Tschudy

-- Other suggestions, such as gravity adjustments in postings?

John Munsch

-- Doesn't have proposal for sulfur; general rule or average probably won't work--doesn't want "cookbook" formula.

David Blackmon

-- Wants to hear ours.

Ben Dillon

- Lease-to-aggregation point quality adjustment is at question--he doesn't understand how such adjustments could/should be made.

Dave Hubbard

- Our intent was to publish differentials stratified by quality.

Deborah Gibbs Tschudy

- Leads to alternative 4 -- methods for MMS to calculate and publish local differentials from lease to market center.

Ben Dillon

- Independents likely to be losers under fixed differentials.

Don Sant

- Doesn't see how IPAA membership can say that they would lose in general.

Ben Dillon

- His membership doesn't like rule overall, and these adjustments fit into the general objection.

John Munsch/Ben Dillon

- Independents think that if they have more than one arm's length exchange, they would be forced to NYMEX.

Valdean Severson

- MMS do action item addressing regulations where multiple exchanges occur?

John Munsch

- Thinks everyone, including royalty owner, benefits when multiple exchanges occur--they occur to reduce transportation costs, increase value, etc.

Dave Darouse

- Answer received on how to allocate gravity back to lease?

Don Sant

- Platt's publishes spot prices for sweet vs. Sour at some locations. May publish differentials for different gravity crudes, but MMS doesn't have a specific answer now.
- Said quality may have to be included in transportation cost/allowance.

Peter Christnacht

- Rule says Companies can come to MMS with special situations and ask for exceptions.

Ben Dillon

- Has MMS analyzed different types of Quality situations?

Don Sant

-- Companies don't want to commingle oils of vastly varying qualities.

Dave Darouse

-- Thinks this is mainly a non-issue offshore.

David Blackmon

-- If two producers have widely varying API gravities would they pay the same price?

Mike Adams

-- Differential from aggregation point to market center includes the quality adjustment. Gravity, sulfur, and transportation from market center to aggregation point are all included.

John Clark

-- What about Permian Basin? At aggregation point, gravity is commingled--may have no relation to lease gravity.

Dave Darouse

-- Doesn't industry have to allocate gravities back to lease all the time?

John Clark

-- Nothing in Midland (Platt's) spot price reflecting transportation to Cushing. Simply represents market in Midland.

Dave Darouse

-- Says this isn't true-- Platt's samples differentials between Midland--Cushing, which leads to Midland spot price.

Deborah Gibbs Tschudy

-- Market center/Cushing differential includes location differentials assessed by Market, quality, transportation.

Peter Christnacht

-- Platt's surveys/assesses differences between Cushing and WTI and other market centers. Confused as to John Clark's problems.

John Clark

-- Quality problems between Midland and Cushing; Midland value downgraded. Also doesn't understand what MMS trying to get to using Cushing price.

Mike Adams

-- Use Cushing price and back out locality differential, transportation to get to lease value.

John Clark

-- Interprets MMS approach as starting with an incremental value.

Deborah Gibbs Tschudy

-- Adjustments are to get back to value at the lease.

John Clark

-- Disagrees with NYMEX as market value; overall crude cost is not spot price.

Mike Adams

-- Says NYMEX is market value.

Don Sant

-- Isn't ANS the incremental/marginal crude to fill up refineries in California?

John Munsch

-- Can't replace, say, Midway--Sunset crude.

Don Sant

-- Quality/Location differentials can address differences.

John Munsch

-- Publications not getting best information regarding spot prices.

Don Sant

-- That's why MMS uses NYMEX. East of Rockies--"perfect" market discovery mechanism. Differentials are the problem.

Ben Dillon

-- How do you decrease audit using differentials under proposed rule?

Don Sant/Deborah Gibbs Tschudy

-- Simply use published numbers and you're done.

Deborah Gibbs Tschudy

-- Rate/zone would reduce administrative workload, add simplicity.

Ben Dillon

-- Doesn't believe we can come up with nationwide zone rates to satisfy independent community.

Don Sant

-- Will never get certainty on case-by-case basis.

Becky McGee

-- Everyone agrees simplicity/certainly desirable, but are we trading off what is truly market value?

Don Sant

-- Not suggesting one rate for country or even GOM; more zones we can define, the better.

John Munsch

-- Says MMS forces everyone to average rate in writing contracts.

Don Sant

-- Doesn't see this, if you could make money by negotiating individually.

Dave Deal

-- Is there possibility that independents might get exceptions to MMS average rate where they believe its' inappropriate for them?

Deborah Gibbs Tschudy

-- MMS considered this, but didn't proceed because only those who felt rate too low would protest.

David Deal

-- Those who feel average is unfair should have some alternative to the average--say, use a range.

Bonn Macey

-- How do we define a range? How to limit it?

Deborah Gibbs Tschudy

-- States impressions of alternative rates?

Dave Darouse

-- Doesn't like them. See exchanges occurring at very low rates/bbl differential. Assigning a fixed rate doesn't seem to capture real market differentials.

Deborah Gibbs Tschudy

-- Couldn't we use actual market rates in the flat rates?

Dave Darouse

-- That's what 4415 would capture.

John Munsch

-- Different benefits accrue to different parties.

Don Sant

-- Under alternative 4, can build differential from lease to market center or other points as appropriate.

Deborah Gibbs Tschudy

-- Intent is, even though there would be winners/losers, to achieve simplicity and certainty.

Dave Deal

-- If averages are properly calculated, alternative might be plausible if some exceptions available (Individual justice vs systemic savings).

Randy Bolles

-- Anytime cost identified, should be allowed. Mixed feelings about using fixed rates--may affect smaller companies greater than large ones. Favors actual costs. Doesn't support fixed rates, on balance.

Valdean Severson

-- Doesn't have position. Lots of options available, but no opinion yet.

Hank Banta

-- Possible to come up with something simple, practical, and fair. Rethinking comments previously sent.

Shawna Hopkins

-- Personally thinks general rates have some merit.

Dave Loomis

-- Still struggling with defining market centers/aggregation points; ideas proposed are interesting, but can't see how could apply in Colorado. Would prefer case-by-case as being more accurate.

(BREAK)

Deborah Gibbs Tschudy

-- To workshop participants--Let's see if we can bring this idea back to discuss next week after you have asked your constituents.

Dave Darouse

-- Fixed rates are for offshore not onshore.

John Munsch

-- Would we consider a rate per mile?

Mike Adams

-- That's worth considering for offshore.

Deborah Gibbs Tschudy

-- What about rate as a percentage of NYMEX?

John Munsch

-- Cost don't change with NYMEX fluctuation.

Deborah Gibbs Tschudy

-- Addressed to Valdean. New Mexico suggested using lowest published rates?

Hank Banta

-- Major lines don't accept common carrier obligation.

John Munsch

-- Might hurt us. Can't negotiate tariffs with Exxon and Texaco.

Deborah Gibbs Tschudy

-- Do you ever file protests?

John Munsch

-- Only for gas. We have not done so for oil.

Deborah Gibbs Tschudy

-- Other ideas?

Ben Dillon

-- What about rates per fields/areas/zones?

Deborah Gibbs Tschudy

-- What I am hearing is that cents per barrel seems preferable.

Mary Stonecipher

-- Distinction, what have you done to simplify audit for two sets of payors--on same lease--how do you audit in this case? Two types of payors pay different rates.

John Munsch

- How do you handle the case where production sold at lease, and payor doesn't have transportation information from lease to aggregation point?

Deborah Gibbs Tschudy

- Lessee pays on gross proceeds.

Ben Dillon

- Lets see that in writing.
- Clarification on calls. IPAA needs more explanation on how this will work. This is a real issue for IPAA.

David Blackmon

- Producers selling production don't want MMS coming back and slapping them with NYMEX. Want to know how this works.

Deborah Gibbs Tschudy

- Of the 3 types of fixed rates, I sense a preference for ¢/barrel approach

(GENERAL AGREEMENT FROM AUDIENCE)

Deborah Gibbs Tschudy

- Now lets discuss Alternative 5, Louisiana's "eliminate NYMEX" step.

Ben Dillon

- IPAA: prefers spot over NYMEX.

David Deal

- API reaction to NYMEX so negative anything is an improvement.

Deborah Gibbs Tschudy

- We were sensitive to the idea that there is a perception that manipulation of Platt's is possible, but NYMEX volume is so large that this would be nearly impossible. But with the differential from Cushing to market centers based on Spot the real effect is spot price anyway.

Becky McGee

- How do you deal with areas of country where spot price volume is thinly traded?

Dave Darouse

- It will work in Louisiana.

Randy Bolles

-- Reluctant to use this. Won't work at Guernsey--it's too thinly traded.

Valdean Severson

-- It's not a problem in the New Mexico market

John Munsch

-- If you go to spot prices, do you think that it affects ability to hedge?

Mike Adams

-- We feel spot determined from NYMEX so it's a non-issue.

Deborah Gibbs Tschudy

-- East of Rockies will the quality differentials be worked in adequately?

John Munsch

-- Spot prices in California crude involve thinly traded volumes.

Deborah Gibbs Tschudy

-- Would Platt's be willing to publish a Salt Lake price?

Mike Adams

-- Might be too thinly traded players won't want to report.

Dave Darouse

-- Platt's won't be too responsive.

Peter Christnacht

-- Bloomberg's/Platt's will be willing to publish data if there is a demand for it, but Mike is correct a vibrant market must exist before the services will survey the data and report it.

Ben Dillon

-- IPAA will stand behind a benchmark for Rocky Mountain regions.

Mary Stonecipher

-- Benchmark four will apply.

David Blackmon

-- Use RIK where exists and number 1.

Becky McGee

-- RIK might apply in other markets.

Deborah Gibbs Tschudy

-- Might not take all oil in kind. We will still need valuation rules for non RIK program

leases.

Carla Wilson

-- RIK should apply to comparable quality.

John Munsch

-- If MMS doesn't take RIK it tells you what real price is. Economic analysis shows you that.

David Darouse

-- In kind program could be used for Benchmark.

Ben Dillon

-- Independents willing to let go of production to gain access to production.

Carla Wilson

-- IPAMS agrees with this.

Randy Bolles

-- The real gain here is not second guessing. Value later.

Domestic Petroleum Council

-- This is very desirable from our perspective.

LUNCH

Deborah Gibbs Tschudy

-- Offers proposal.

-- For OCS & Mid-Continent

(a) affiliates-- non-refiner: affiliate resale less transp.

(b) affiliate & refiners: spot less fixed differential

-- Rocky Mountain. Region (to be defined) (ND,MT,WY,CO,UT)

Benchmarks 1. RIK (competitive program)

2. Tendering Program (double the royalty rate)

3. Combination of lessee sales & purchases 50 percent pf lessee's

equity production

4. Netback

-- California

ANS less fixed differentials

Discussions By Several People

-- Definition of Rocky Mountain area and the RIK program--would have to be a competitive program unlike existing one. Also, could we use RIK prices from, say, CO, to value WY crude?

-- On further modifications to Deborah Gibbs Tschudy's proposal--perhaps put tendering & RIK ahead of other OCS and Mid Continent options.

Randy Bolles

-- Would want to add affiliate resale option in Rocky Mountains.

Becky McGee

-- Seems all options should be listed in each region and not used if inappropriate for that region.

Randy Bolles

-- Majority of volumes in Wyoming exchanged. (Usually under a spot price--Cushing, Midland, etc.)

Deborah Gibbs Tschudy

-- Would Randy support affiliate non-refiner resales?

Randy Bolles

-- Probably so.

Deborah Gibbs Tschudy

-- Revised suggested benchmarks (Randy Bolles)
→Affiliate/non-refiner: resale less transp (incl. "Hard costs")
→Affiliate/Refiner: OCS/Mid Con--spot
→Rocky Mountains: 1. Tendering
2. Lease-based (comparable) (including RIK)
3. Netback

David Blackmon

-- Why not also accept negotiated value between parties? (In addition to tracing options)

Ben Dillon

-- Thinks IPAA position on affiliate resales has been taken out of context.

Mary Stonecipher

-- Thinks there's misconception of meaning of resale--Deborah Gibbs Tschudy means immediate "flip," or resale, of production affiliate receives/buys from affiliate, in field or at lease.

Ben Dillon

-- MMS should take all production in kind.

John Clark

-- MMS has already taken large volumes of oil in kind, plus mandated set-aside program. MMS not only royalty owner he has to satisfy. Thinks, say, 32 percent, is too much to be

required under tendering. (John Munsch Concur)

Ben Dillon

- Suggested method:
Benchmarks Refiners & Non-refiners--onshore/OCS & CA
 1. Tendering (10%)
 2. Comparable (lease-based)(incl. RIK) (incl. Sales & purchases) (10%)
 3. Netback
 - Refiners--spot less all costs
 - Non-refiners--trace (resale less all costs)
 4. Negotiated method

Carla Wilson

- Alternative Benchmarks
 1. Lease-based
 2. Tendering
 3. Netback

Don Sant

- Is sale 100 miles away, less transpiration, indicative of lease-based sale?

General Discussion

- Most seemed to think this would be a lease-based sale, but not unanimous. If move within field or area, probably would be considered lease-based.

John Clark

- "John/taxpayer"
Benchmarks (nationwide)
 1. Tendering
 2. Comparable
 3. Calculated Price: P+ minus costs

Dave Deal

- presumptive differentials

Dave Darouse

- OCS
- Non-arm's-length sales: spot less exchange diff's (actualities) less actual transp.
- Maintain 4415 where no flow to market center.
- Recommends using same price for all oil flowing to an aggregation point, since is all 8-G oil and should make no difference to government (don't make gravity adjustments).
- Nothing constructive to add onshore.

John Munsch

- Says this would complicate lease accounting, since owners would have to be paid based on their actual oil quality.

Peter Christnacht

- Asked John Clark if, in Conoco's tendering program, they didn't have to have differential information available

John Clark

- Said upstream and downstream operations separate and this info not readily transferrable between them. Thinks 4415 info requirements too stringent since info spread throughout Company.

Dave Darouse

- Are local differentials erratic throughout year?

John Munsch

- Don't fluctuate wildly.

Action Item List

1. Discuss alternative to expanded duty to Market crude oil.
2. Consider separate rules for California, OCS, Rocky Mountain Region.
3. Differences of like-quality, field or area, percent of production under tendering program.
4. Refiner vs. Non-Refiner rule
 - Arm's length non-refiner
 - Index price netback for refiner
5. Identify and quantify costs from index prices.
6. Wyoming proposed--MMS published prices.

Alternative 2

Benchmark 1-

- Definition of "like quality" or comparable.
- Definition of "field or area."
- Min/sufficient sales or purchases (90/10 control issue).

Benchmark 3-

- Access in timely manner.
- Definition of "access to."

- Certainty?
- Reduce audit burden?
- Assure these contracts are arm's length and reflect total consideration?
- 90/10 control issue

7. Multiple exchanges (buy/sell) Arm's Length

- ### 8. Fixed rate differentials
- How to accommodate winners/losers?
 - Onshore vs. OCS.
 - Areas/fields/zones.

Valdean Severson's Option

- New Mexico -- separate rule
- Refiner
 - tendering \geq Royalty Rate
 - NYMEX or spot less actual differentials or negotiated differentials less marketing costs
 - Non-refiner (tender?)

- Elect one year at a time one or the other
- Trace
 - { less actual differentials
 - { less marketing costs
 - Spot or NYMEX less actual or negotiated differentials

Ben Dillon

- What does MMS expect, specifically, from attendees at next meeting--i.e., concerning "comparability"?

Deborah Gibbs Tschudy

- Give us ideas on criteria-- e.g., within 20% of volume of contract comparing against.

Ben Dillon/David Blackmon

- Regarding "duty to market", will MMS later come back and second-guess companies' royalty payments concerning marketing costs?

David Blackmon

- Still appears to be a problem when there's a non-arm's-length sale at lease--no obvious allowance for any transportation.

Agenda for October 7 - October 8, 1997

- Donuts/Bagels
- Lease based/comparable benchmark
 - like-quality
 - field or area
- Marketing Costs
- Duty to market
- Multiple exchanges
- Crude Oil Calls
- Lease to aggregation point
- Valuation alternatives